

The For-Profit School: A Bankruptcy Trend Worth Watching

Law360, New York (June 18, 2015, 10:29 AM ET) --

It is a rare circumstance where a for-profit college files bankruptcy because filing means immediate loss of its main funding source under Title IV of the Higher Education Act of 1965, but, in this case, Corinthian Schools Inc.[1] had no other option. Because of rigorous and now-continuous scrutiny that for-profit higher education institutions are now facing from governmental bodies like state attorney generals, the U.S. Department of Justice and the Consumer Financial Protection Bureau, among others[2], for-profit schools are being targeted by these governmental agencies and forced to close their doors. Because of this, for-profit school bankruptcies may very well be the next bankruptcy trend.



Katherine R. Catanese

Corinthian's problems began over four years ago when the U.S. General Accountability Office found that Corinthian engaged in deceptive or fraudulent practices in the enrollment and financial aid process.[3] Then, in November, 2013, the U.S. Consumer Financial Protection Bureau announced that it was investigating Corinthian.[4] On June 12, 2014, and without notice, the U.S. Department of Education informed Corinthian that the DOE would be revoking Corinthian's Title IV eligibility under the Higher Education Act, withholding access to Title IV federal student aid funding from Corinthian.[5] Nearly 90 percent of Corinthian's revenues came from Title IV funds.[6]

Corinthian sought financial relief from the DOE, which granted \$16 million in student aid so Corinthian could keep its schools open until it could sell them and thereby avoid closing while students completed their classes.[7] Then, on Nov. 19, 2014, Corinthian sold 56 of its campuses to Zenith Education Group Inc.[8] The sale did not include sales of California campuses because the California attorney general imposed significant financial and operational obligations on Zenith.[9]

Corinthian could not sell any of the remaining educational institutions after the DOE placed significant financial and operational obligations on Corinthian and potential buyers.[10] The DOE then fined Corinthian \$30 million dollars for Corinthian's inability to sell institutions that it had acquired in 2010 when Corinthian purchased Heald Capital LLC.[11] The California attorney general also failed to come to an agreement in negotiations with potential buyers.[12] On April 23, 2015, Corinthian then wound down operations after failing to find any buyers and shut its doors — ending classes for its approximately 16,000 students.[13]

Shortly thereafter, on May 4, 2015, Corinthian and its affiliates filed for Chapter 11 bankruptcy in the U.S. Bankruptcy Court in Wilmington, Delaware — an unprecedented move.[14] Traditionally, for-profit schools do not file bankruptcy because institutions of higher learning that file for bankruptcy are ineligible to receive Title IV funds.[15] When an institution or its management company files for bankruptcy, the DOE immediately cuts off access to federal funds, and this abrupt elimination of funding is nondiscretionary. Title IV funding accounts for about 80 percent of funding received by for-profit institutions; removal of this funding is crippling to the school.[16]

Therefore, students are using the Corinthian bankruptcy as a platform to challenge repayment of their student loans, and the Obama administration is listening. Because of, in part, the force of the Debt Collective, often called the "Corinthian 100," a group of disgruntled former Corinthian students, "[t]he Obama administration said it would forgive federal student loans owed by Americans who can show they were lured to colleges by fraudulent recruiting, a move that potentially could involve billions of dollars and is one of the most aggressive measures yet to ease student debt." [17] This means that 350,000 former Corinthian students with loans totaling \$3.5 billion could be eligible for forgiveness. [18]

Obama's murky plan is still emerging but allows debt forgiveness "as long as the borrower can document a school persuaded him or her to take out the loan under conditions that would violate state laws." [19] It is unclear at this point how this requirement will be interpreted and how it will be evaluated. [20] It also is unclear how this regulation will jive with the Bankruptcy Code, which prohibits student loans from being dischargeable in bankruptcy absent "undue hardship." [21]

In addition to Obama's new plan to allow student loan debt forgiveness, the gainful employment regulations go into effect on July 1, 2015, which require a for-profit institution to meet certain government-created standards in order to maintain its funding. [22] According to one source, about 1,400 programs serving 840,000 students could not pass the gainful employment regulations. [23]

Currently, other for-profit educational institutions are facing economic and legal difficulties, similar to what Corinthian faced prior to filing bankruptcy. On Feb. 26, 2014, the Consumer Financial Protection Bureau filed suit in the U.S. District Court for the Southern District of Indiana against ITT Educational Services, alleging that ITT engaged in violations of the Consumer Financial Protection Act of 2010 and the Truth in Lending Act by misleading students with overstated job prospects and salaries upon graduation and pushing students into predatory loans. [24] Then, in May 2015, the U.S. Securities Exchange Commission filed suit against ITT in the federal district court in Indiana for fraud for allegedly concealing massive losses; this is after the DOE had already put ITT on a heightened cash monitoring program, causing delays in funding. [25]

Expectedly, enrollment is significantly down at major for-profit institutions. University of Phoenix enrolled 213,800 students in 2014, fewer than one-half of the students that enrolled in 2010. [26] In April 2015, DeVry University closed 14 campuses and Jones International University announced that it would shut down. [27]

The culmination of not just the sharp decline in enrollment, investigations by very powerful government organizations including the Department of Justice and state attorney generals, who have now coalesced and joined forces, but also Obama's student loan debt forgiveness plan and the soon to go into effect gainful employment regulations, which could wipe out Title IV funding for schools, for-profit schools are in trouble. Their sustainability in this environment when the government controls its funding is challenging at best. Corinthian may have been one of the first for-profit schools to file bankruptcy [28] but it will likely not be the last.

—By Katherine R. Catanese, Foley & Lardner LLP

Katie Catanese is a senior counsel in Foley & Lardner's New York office.

The author thanks Jennifer Slocum, Benjamin Bassoff and Stefan M. Canizares who assisted

in the writing of this article.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Corinthian was a large postsecondary educational company with approximately 74,000 students that has operated for-profit educational institutions since 1995. Declaration of William J. Nolan [Chief Restructuring Officer] In Support of Chapter 11 Petitions and First Day Motions ("First Day Decl."), ¶8, dkt. No. 10, Case no. 15-10952, United States Bankruptcy Court for the District of Delaware.

The institutions offered career-oriented diploma and degree programs in fields including health care, business, criminal justice, construction trades and information technology. Id. Corinthian operated over 100 campuses in several states in the United States and in Canada. Id.

[2] In fact, on Oct. 30, 2014, the Obama administration issued a press release indicating that the U.S. Department of Education had formed an interagency oversight task force with the goal to "leverage their resources and expertise to assist one another, thereby making the best use of scarce resources and better protecting the interests of students and taxpayers." See <http://www.ed.gov/news/press-releases/obama-administration-announces-final-rules-protect-students-poor-performing-career-college-programs>

[3] Tamar Lewin, Senator to Review Accreditation of for-Profit Colleges, N.Y. Times, Aug. 4, 2010

[4] Carter Daugherty, For-Profit Colleges Face Consumer Bureau Probe on Lending Roles, Bloomberg, Nov. 23, 2013.

[5] First Day Decl. ¶21.

[6] First Day Decl. ¶14.

[7] Danielle Douglas-Gabriel, How Dozens of Failing For-Profit Schools Found an Unlikely Savior: A Debt Collector, Wash. Post, Nov. 28, 2014.

[8] First Day Decl. ¶ 25.

[9] First Day Decl. ¶ 25.

[10] First Day Decl. ¶ 29.

[11] First Day Decl. ¶ 29.

[12] First Day Decl. ¶ 29.

[13] First Day Decl. ¶ 31.

[14] Corinthian's petition lists more than \$100 million in debt owed to its secured lenders and at least \$100 million more in unsecured debt and \$19.2 million in assets. See dkt. No. 1, Case no. 15-10952, United States Bankruptcy Court for the District of Delaware.

[15] See Title IV of the Higher Education Act of 1965, 20 U.S.C. § 1002(a)(4)(A).

[16] James Marshall Crotty, Obama Tightens the Screws on For-Profit Colleges, *Forbes*, Oct. 30, 2014.

[17] Josh Mitchell, Obama Administration Opens Door for More Student-Debt Forgiveness, *Wall Street Journal*, June 8, 2015.

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] See 11 U.S.C. § 523(a)(8), which states that student loan debt is not dischargeable “unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor’s dependents, for —

(A)

(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual”.

[22] Allie Bidwell, Education Department’s Gainful Employment Rules Rebuffed, *U.S. News*, Oct. 30, 2014.

[23] *Id.*

[24] Paul Fain, Problems Deepen for ITT, *Inside Higher Ed*, May 13, 2015.

[25] *Id.*

[26] Paul Fain, Vanishing Profit, and Campuses, *Inside Higher Ed.*, May 7, 2015.

[27] *Id.*

[28] Anthem Education Group, a for-profit chain of colleges and career institutes, filed for bankruptcy in August 2014 because of significant enrollment losses. Charlie Tyson, Anthem Bows Out, *Inside Higher Ed.*, Aug. 29, 2014. Anthem served roughly 10,000 students at the time of bankruptcy, less than half of the amount of students enrolled in 2006. *Id.* Before filing for bankruptcy, like Corinthian, Anthem sold 14 of its campuses. *Id.* It attempted to avoid the loss of Title IV funds before selling off assets because, like Corinthian, nearly 90 percent of Anthem’s revenues came from Title IV funds and access to Title IV funds is immediately revoked upon filing for bankruptcy. *Id.* At the time that Anthem filed for

bankruptcy, Anthem's estimated assets were between \$1 million and \$10 million, with \$50 million to \$100 million in debts. Id.

All Content © 2003-2015, Portfolio Media, Inc.